

Public Service Commission of Wisconsin
Rebuttal Testimony of Lois Hubert
Gas and Energy Division

Wisconsin Energy Corporation
Docket 9400-YO-100

February 19, 2015

1 Q. Please state your name.

2 A. My name is Lois J. Hubert.

3 Q. Did you also provide direct testimony in this docket?

4 A. Yes.

5 Q. What is the purpose of your rebuttal testimony?

6 A. The purpose of my testimony is to respond to rebuttal testimony from Allen Leverett and
7 Scott Lauber given on behalf of Wisconsin Energy Corporation (WEC or applicant).

8 Q. Do you have any preliminary comments on the proposed acquisition conditions?

9 A. Yes. As shown on Ex.-WEC-Lauber-4, there are 93 conditions proposed either by
10 Commission staff and/or intervenors which the Commission may wish to consider to
11 ensure that the acquisition is in the best interest of shareholders, ratepayers, and the
12 public. Some of these are standard conditions that this Commission has typically
13 imposed for mergers while others are specific to this acquisition. Any conditions
14 ultimately deemed necessary by the Commission should be incorporated in the Final
15 Decision in this docket.

16 Q. Why do you believe that Commission-approved conditions, including those already
17 agreed to by the applicant, be incorporated in the Final Decision?

18 A. The rebuttal testimonies of the applicant's witnesses contain numerous clarified and
19 conditional acceptances of the proposed conditions. In some instances, the applicant's

1 concurrence with a proposed condition is so heavily clarified that it amounts to an
2 opposition of the condition. Because of the applicant's conditional agreement,
3 Commission staff finds it necessary to further discuss and clarify the proposed
4 conditions, some of which are standard holding company conditions, for items which the
5 applicant gives the appearance of being reasonably accommodating. In such an
6 environment, it is important for the Commission to clearly state its expectations and
7 requirements to avoid future misunderstandings or misinterpretations.

8 **Rebuttal-WEC-Leverett**

9 Q. On Rebuttal-WEC-Leverett-3, Mr. Leverett states that "The conditions that Staff and
10 intervenors are proposing regarding ATC are completely unnecessary and the
11 Commission should not adopt them." Do you agree with Mr. Leverett's statement?

12 A. No. While the applicant is willing to limit its voting power on the election of directors, it
13 insists on retaining a majority voting position on fundamental corporate matters. It is the
14 fundamental corporate matters which determine the essence of the entity. This means
15 that the future of ATC, whether it remains a standalone entity, or merges with another
16 company; whether it remains closely held or becomes publicly traded; will be determined
17 by one entity – WEC Energy – even if all of the approximately two dozen Wisconsin
18 ATC owners do not wish to take that route.

19 The issue is not whether WEC Energy will have control on matters affecting the
20 management, operations, or planning activities, but whether WEC Energy alone should
21 have control of deciding matters which could affect the ownership interest of the other
22 owners, such as being acquired by a third party against their choice, because the terms
23 suit WEC Energy's purposes. The issue is whether such power or authority is in the best

1 public interest. Commission staff's proposals are intended to inhibit such power while
2 allowing WEC Energy to retain the financial benefits that accrue from its majority
3 ownership. It is important to note that while ATC is subject to Commission jurisdiction
4 under a variety of statutes, ATC is treated differently than other utilities.

5 In Rebuttal-WEC-Leverett-3, lines 18 through 19, Mr. Leverett states "As a result
6 of our proposal, the combined company will have the same influence that Integrys does
7 today on matters affecting the management operations or planning activities of ATC."
8 However, Commission staff's proposed conditions are intended to limit WEC Energy's
9 influence on ATC's corporate future, which after the acquisition will be concentrated in
10 WEC Energy alone. These are areas which could have strong economic impact on the
11 other owners.

12 Q. But Mr. Leverett says in Rebuttal-WEC-Leverett-12 that "The economic positions of all
13 ATC owners are protected by the company's governing documents."

14 A. This is the only support Mr. Leverett gives for arguing against Commission staff's
15 proposed voting restrictions. However, WEC proposes to retain its full majority voting
16 interest on issues relating to amendments to ATC LLC's or ATC Management's
17 governing documents. I have previously testified on the potential for these documents to
18 be changed such that WEC Energy could gain effective control.

19 Q. Please comment on the statement on Rebuttal-WEC-Leverett-5 that only Great Lakes
20 Utilities (GLU) has raised the issue on voting restrictions, so GLU's and Commission
21 staff's conditions should be rejected.

22 A. While GLU is the only ATC owner to file testimony on this issue, it may not be the only
23 entity to question the practical effect of WEC's proposed voting restriction. Commission

1 staff's questions regarding whether the WEC voting proposal is adequate to ensure the
2 public interest arose from its public interest review. The Commission must determine,
3 based on the evidence in this record, whether the consolidation of ATC ownership is in
4 the best public interest.

5 Q. Do you wish to comment on WEC's historic 51 percent ownership interest in ATC, as
6 referenced on Rebuttal-WEC-Leverett-6?

7 A. Yes. I cannot testify on the legislative or Commission intent regarding the formation of
8 ATC. However, I can testify on how long WEC held the 51 percent ownership
9 referenced. Schedule 1 of Ex.-PSC-Hubert-2 is the page from Schedule A to the
10 Operating Agreement filed on June 30, 2001. It is the earliest Schedule A available on
11 the Commission's ERF system. It shows that as of June 30, 2001, within six months of
12 ATC's formation, WEC's investment was already down to 42.61 percent (37.42 percent
13 for Wisconsin Electric Power Company and 5.19 percent for Edison Sault Electric
14 Company).¹ Schedule 2 of Ex.-PSC-Hubert-2 is a table with the ATC Member
15 Ownership Percentages at year end for 2001 through 2013 and for June 30, 2014. It was
16 provided in response to Michigan Staff Data Request 01-HJM.² As shown in this
17 Schedule, no entity has held a majority interest in ATC since shortly after formation and
18 the Member Ownership Percentages have remained relatively stable since December 31,
19 2008. Lastly, regardless of their motives for joining ATC, a substantial number of utility
20 providers, including other Wisconsin utilities, currently hold an approximate 40 percent
21 ownership interest in ATC over which WEC will have gained effective control.

22 Q. Do you have any comment on ATC directorships?

¹ For full report, see [PSC REF#: 71757](#).

² Page 9 of [PSC REF#: 219900](#).

1 A. Yes. GLU has proposed a condition (proposed Conditions 23 and 24) that the smaller
2 utility-owners be given a position on the ATC board. My thoughts upon reading that
3 proposal is that it would add more diversity of opinions to ATC's board. Furthermore,
4 the designated one-year term position currently held by WPSC would be available under
5 the current bylaws. Since these board positions are no longer statutorily tied to any
6 entity, there should be no prohibitions on this proposal.

7 On Lines 12 through 16 of Rebuttal-WEC-Leverett-3, Mr. Leverett states that
8 "WEC and Integrys highly value the independent and collaborative manner in which
9 ATC has planned and managed the transmission networks in Wisconsin and the Upper
10 Peninsula of Michigan and have no desire to exert additional influence over the
11 management, operations, or planning activities of ATC." Contrarily, Mr. Leverett
12 opposes granting the small owners a seat on the board of directors. Mr. Leverett is a
13 member of ATC's Nominating and Board Affairs Committee,³ with influence over
14 whether ATC minority owners would be granted a seat on the board.

15 Q. Do you have any other comments on the ATC-related proposed conditions?

16 A. Yes. I believe Ex.-WEC-Lauber-4 missed a proposed condition relating to ATC. In
17 Direct-GLU-Lowry-28 beginning on line 19, Mr. Lowry states:

18 To ensure geographic diversity and a stronger voice for parties demanding
19 competitive markets and efficient transmission service provision, the
20 divestiture could be accomplished by making the appropriate portion of
21 WEC's 26% share available in a voting trust for purchase at a fair market
22 price by Wisconsin municipal utilities and cooperatives, including the
23 current municipal and cooperative owners of ATC.

24 I will add this as proposed Condition 94 on the decision matrix that will be provided to
25 the Commission to aid in its decision-making.

³ ATC response to PSCW's Request No. 02.13. ([PSC REF#: 225204.](#))

1 Q. Please clarify whether you proposed making the two-year union-represented employee
2 retention commitment referred to in Rebuttal-WEC-Leverett-15.

3 A. No, I did not propose that the applicant make such a commitment. Rather, this
4 commitment was proposed by the applicant on page 5 of its application.⁴ In my direct
5 testimony, I note that the applicant has not offered the same commitment to
6 non-represented employees. I do not take a position on this proposed commitment.

7 **Rebuttal-WEC-Lauber**

8 Q. Please comment on the importance of ring-fencing utility operations from holding
9 company activities, in general.

10 A. Dividend restrictions are considered “ring-fencing” provisions because they provide a
11 layer of protection to the utilities and their customers from the activities of the holding
12 companies. Other ring-fencing provisions include restricting lending to affiliates,
13 prohibiting guarantees for an affiliate’s obligations, and preventing co-borrowing with
14 affiliates.

15 Ring-fencing restrictions are not new concepts and the basic foundations for the
16 Commission’s delineated ring-fencing provisions have been included in Wis. Stat.
17 § 196.795, since its enactment in 1985. Credit rating agencies have often cited
18 Wisconsin’s dividend restrictions as positives for Wisconsin utilities’ credit ratings.
19 Most recently, Fitch noted in its June 24, 2014, report regarding the acquisition:

20 *Regulatory* restrictions regarding upstream dividend distributions to WEC
21 provide some level of credit protection and mitigate contagion risk to the
22 utilities from higher leverage at the parent. (*Emphasis added.*)

⁴ [PSC REF#: 213332](#).

1 Relatedly, Standard & Poor's noted in its June 24, 2014, report regarding the
2 acquisition:

3 Ratings stability for WEPCO, WG, and WPS reflects sufficient regulatory
4 insulation and their stand-alone credit profiles, which would be unaffected
5 by the transaction.

6 One of the reasons for the credit watches is that the high level of new debt
7 required for the acquisition will cause a deterioration in WEC's financial strength, as
8 measured by the credit matrices, placing it on the lower edge of its current credit ratings.

9 It is uncertain if its actual credit metrics will be lower than forecasted, pushing the
10 financial strength below the credit ratings floors, hence the credit watch. WEPCO's,
11 WG's, and WPSC's (Collectively the Wisconsin Operating Companies) credit metrics are
12 unaffected (as S&P notes above) unless WEC Energy (*aka* the new holding
13 company/combined company) takes actions such as removing funds from, shifting costs
14 to, or shifting debt to the utilities. If WEC Energy's financial strength falls sufficiently,
15 the Wisconsin Operating Companies' credit ratings could be pulled down by association.

16 As I just noted, the credit metrics of WEC will deteriorate when it acquires
17 Integrys, regardless of whether its credit ratings falls. This is not a blip. WEC's lower
18 financial metrics will remain until WEC Energy reduces its debt or grows its earnings.
19 The company's financial strength may never be restored to current levels. WPS
20 Resources Corporation (Integrys' predecessor) had Senior Unsecured ratings of A1
21 before the Integrys formation and Integrys' current ratings is A3, and this only after being
22 upgraded last year from Baa1 upon the sale of Integrys Energy Services. Ring-fencing
23 cannot prevent the Wisconsin Operating Companies from being downgraded if the
24 holding company's financial strength deteriorates sufficiently, however, it can help to
25 maintain financially strong Wisconsin utilities.

1 On July 28, 2000, shortly after the April 26, 2000, WEC acquisition of WICOR,
2 the board of directors of WG authorized a \$255,000,000 dividend to WICOR, the
3 sub-holding company under WEC, financed by a promissory note to WICOR. On
4 December 14, 2000, the board authorized a similar transaction for an additional
5 \$55 million.⁵ On December 4, 2001, in dockets 6650-SB-108, 05-BS-104, and
6 6650-SB-109, WEPCO and WG signed a Stipulation and Consent Order agreeing among
7 other things to return the dividend payments to WG. This stipulation is shown as
8 Schedule 3 of Ex.-PSC-Hubert-2. The temptation to reduce acquisition debt at the
9 expense of the operating companies increases with the additional Integrys Energy
10 acquisition debt. Consequently, the Commission may wish to not only continue the
11 ring-fencing provisions already in place, but also strengthen these provisions in this
12 docket, by adopting and reasserting the proposed Conditions 36 and 37, respectively.

13 Q. Please comment on Mr. Lauber's acceptance of your proposed dividend restriction
14 conditions provided they are duplications of existing Commission requirements.

15 A. For purposes of the Commission's decision in this docket, I will be treating Commission
16 staff's proposed dividend restriction conditions as contested. The reason for this is that the
17 intent of these conditions is not to simply duplicate the requirements of the rate case order.
18 If approved, these dividend restrictions will be different than those currently established by
19 the Commission for the Wisconsin Operating Companies.

20 Regarding proposed Condition 37, the language of the current dividend restrictions
21 established in dockets 5-UR-107 and 6690-UR-123 is changed to conform the restrictions
22 of the three operating companies. This is shown on Direct-PSC-Hubert-14. The current

⁵ The combined payment amounted to approximately ten times the previous annual dividend payments.

1 rate case dividend restriction would be superseded by any restrictions imposed by the
2 Commission in this docket upon consummation of the acquisition. Provided the Wisconsin
3 Operating Companies maintain their actual average common equity ratio, on a financial
4 basis, at or above that included in the last rate case, the change will not affect the
5 companies.

6 Regarding proposed Condition 36, this is an additional dividend restriction. It
7 would become effective upon consummation of the acquisition. Provided the Wisconsin
8 Operating Companies maintain their actual common equity above the equity range floor
9 set by the Commission in the last rate case, the change will not affect the companies. Its
10 purpose is to stop all dividends to the holding company in the event that the utility's
11 equity ratio falls below the range that the Commission found reasonable in the last rate
12 proceedings. If the utility is not maintaining the minimum equity found reasonable by
13 this Commission, it should not be flowing dividends to the holding company.

14 In addition, proposed Condition 1 would allow Transaction costs, while not
15 recoverable in rates, to be allocated to non-utility accounts. From a regulatory
16 accounting perspective this may be acceptable; however, from a financial perspective,
17 meaningful allocations to non-utility accounts could have adverse impacts on the capital
18 accounts and financial metrics. Consequently, if the Commission disallows all
19 Transaction costs (as all parties agree), but allows allocation to non-utility accounts as
20 worded in proposed Condition 1, it is even more important to put a floor on when
21 dividends should be prohibited.

22 This docket is the appropriate time to address changes to the current dividend
23 restrictions. The restrictions are part of the ring-fencing provisions for holding

1 companies. Had these proposals been made in the last rate proceedings, the companies
2 would have argued that it was premature and the issue not ripe for review. Inclusion of
3 dividend restrictions in rate cases is generally for the purpose of affirming them and
4 conforming the dividends and equity levels to the specific numbers established in the rate
5 case.

6 Lastly, relating to Mr. Lauber's comments about "imposing conditions in this
7 proceeding that inadvertently create tension with rate case orders", I am not aware of any
8 time, in the 30-years that the Commission has been imposing dividend restrictions, that it
9 was necessary to clarify that the previous dividend restriction is rescinded and replaced
10 with the newer one. However, if the Commission so instructs, the order may state for
11 clarity that the dividend restrictions replace the currently effective dividend restrictions.

12 Q. Do you have any comments on proposed Condition 38 of Ex.-WEC-Lauber-4?

13 A. Yes. While I have not taken a position on Mr. Hahn's proposal, I would like to state that
14 I do not agree with Mr. Lauber's statement on Rebuttal-WEC-Lauber-6 that "Mr. Hahn's
15 proposed condition would be superfluous, given the Commission's authority to restrict
16 dividend payments under the Holding Company Act."

17 Mr. Lauber appears to believe that the power to regulate dividend restrictions is
18 the same thing as exercising that power. The holding company statute clearly allows
19 dividend restrictions as noted by Mr. Lauber. Mr. Hahn is not simply reiterating the
20 authority of the Commission, he is asking the Commission to exercise that authority in a
21 specific manner. If the Commission found merit in Mr. Hahn's proposal, it could require
22 the Wisconsin Operating Companies to meet both the capitalization requirements and a
23 payout ratio test.

1 Q. Do you have any comments regarding proposed Condition 42 of Ex.-WEC-Lauber-4,
2 requiring WEC Energy to absorb any additional capital costs related to holding company
3 downgrading?

4 A. Yes, I have three. First, while the credit ratings of the Wisconsin Operating Companies
5 have not been placed on credit watch as a result of the proposed acquisition, the condition
6 does not relate only to the acquisition. It will be an ongoing condition and future actions
7 of the holding company which could affect the credit ratings would be included.

8 Second, in response to Mr. Lauber's comment on Rebuttal-WEC-Lauber-8 that
9 "even assuming a downgrade were to occur, it would be nearly impossible to disentangle
10 the factors contributing to such a hypothetical downgrade", I have included Schedule 4 of
11 Ex.-PSC-Hubert-2. Schedule 4 is a Moody's Investors Service Rating Action of
12 February 21, 2007, which clearly indicates that WPSC was being downgraded because of
13 the Integrys Holding Company formation. I am sure that some reports are not as clear;
14 however, an indication would be whether the holding company or affiliate and the
15 Wisconsin utility are both downgraded. Another would be wording of the credit report.
16 Regardless, Commission deliberation and discretion will determine whether holding
17 company action likely impacted the downgrade.

18 Third, the calculation of the costs related to a downgrade is a simple calculation.
19 Bond spreads are publicly available, and any proration for notching changes would also
20 be simple. For every ten basis point reduction in the cost of a \$250 million bond issuance
21 the reduction would be \$250,000 a year.

1 Q. Please comment on Mr. Lauber's related statement on Rebuttal-WEC-Lauber-8 that "one
2 of the potential reasons credit ratings could be downgraded would be if the Commission
3 imposed unduly burdensome conditions in this case."

4 A. As noted in previous testimony, the concern that has been expressed by the ratings
5 agencies is that WEC will borrow \$1.5 billion to finance this acquisition and
6 consequently weaken its financial profile. WEC set the terms acceptable to it, which was
7 1.128 WEC shares plus \$18.58 in cash for each Integrys share. The result of these terms
8 is the need for \$1.5 billion of new debt. WEC could have made an all-stock offer or
9 something with less cash payment. Under those options, Integrys stockholders would
10 have gotten more ownership in WEC Energy, and would not have as large of a tax
11 liability that they now will incur. Furthermore, WEC has made concessions in other
12 jurisdictions, most notably the sale of all WEPCO and WPSC electric distribution assets
13 in the Upper Peninsula of Michigan and the sale of the Presque Isle Power Plant, which
14 Michigan requires be completed before or concurrently with the Transaction, not in five
15 to ten years.

16 The applicant and its board should have considered all of these known and
17 potential items, and their potential credit impact, when it negotiated the terms of the
18 acquisition. Any conditions ensuring customer protection and benefits established by this
19 Commission would not be the primary cause of the downgrade. Rather WEC's focus on
20 maximizing shareholder benefit, and the resulting increase in debt, could cause a
21 downgrade.

22 Q. Do you have any comments on proposed Conditions 43 and 44 of Ex.-WEC-Lauber-4?

1 A. I will treat these two Conditions as uncontested. However, I note that the specified
2 activities are not intended to limit issues the Commission may address under the related
3 statutes.

4 The Commission has in the past addressed money pools and guarantees and there
5 is case precedence in these issues, so including these conditions in the order is not
6 inconsistent with past Commission determinations. Including these in the holding
7 company acquisition order provides clarification which may forestall fruitless filings as
8 other holding companies have done.

9 Q. What is your position on the proposed Condition 46 of Ex.-WEC-Lauber-4?

10 A. I believe that timely monitoring of the debt is required; however, to the extent that there
11 is no change, quarterly reports would not be necessary. Consequently, I propose to revise
12 this proposed condition to state:

13 WEC Energy shall file with the Commission, within 90 days of the
14 consummation of the acquisition, a report detailing the debt held at the
15 WEC Group holding company and Integrys sub-holding company levels,
16 its relationship to total holding company debt, and the company's plans to
17 reduce the debt. WEC Energy shall file with the Commission updated
18 reports *annually* until the debt at the holding companies declines to
19 15 percent of total debt. *WEC Energy shall notify the Commission within*
20 *30-days of any changes to the debt reduction plan or holding company*
21 *debt. (Modifications in italics.)*

22 Q. Please comment on proposed Conditions 61 and 62.

23 A. Schedule 1 of Ex.-PSC-Hubert-1 erroneously labeled the corporate and operational
24 headquarters as issues raised by Commission Staff witness Kristy Nieto; consequently I
25 will address Mr. Lauber's comments. Based on Mr. Lauber's testimony, I will treat the
26 issue as contested even though it is shown on Ex.-WEC-Lauber-4 as accepted.

27 Two options were included for both conditions. I would support the first option
28 in each. WEC also indicates on Ex.-WEC-Lauber-4 that the first is acceptable. On

1 Rebuttal-WEC-Lauber-11, Mr. Lauber testifies that these conditions “are consistent with
2 commitments WEC made in its application.” These proposed conditions are:

3 The headquarters of the post-merger WEC Energy Group and associated
4 jobs will be located in Wisconsin and critical decisions affecting energy
5 policy in Wisconsin will continue to be made in Wisconsin.

6 and

7 WEC Energy shall maintain operational headquarters in the cities of
8 Milwaukee and Green Bay.

9 These conditions are examples of the applicant agreeing to a condition and then
10 quantifying the acceptance to such a point that the condition is ineffective if accepted
11 under WEC’s qualifications. WEC does not want to be bound by these commitments.
12 WEC states that the Commission should rely on the fact that WEC does not currently
13 have a plan to move the headquarters, and therefore no order point is warranted.

14 I disagree. Not only has WEC committed in its application to remaining in
15 Wisconsin, it has used it in its talking points to the public. Such a talking point is likely
16 to assure some individuals who would oppose moving jobs out of Wisconsin, or out of
17 Milwaukee or Green Bay. The applicant’s lack of a firm commitment raises concerns
18 about whether: 1) WEC Energy is considering a future move (such as to Chicago, IL) but
19 has not yet done the formal planning; or 2) is retaining the headquarters’ location(s)
20 selection as a possible bargaining option for an Illinois acquisition approval. If the
21 Commission wishes the headquarters and associated jobs to remain in Wisconsin, it
22 should condition the acquisition on such conditions. The Commission could, if it wished,
23 set a minimal retention period of five, ten, or more years.

24 Q. Please comment on proposed Condition 68, levelization of WEPCO and WPSC rates.

1 A. I will treat proposed Condition 68 as a contested issue. I do not agree with the applicant
2 that “conferring” is generally consistent with Commission staff’s proposal to develop a
3 proposal that is acceptable to the parties. The applicant questions whether a consensus
4 could ever be reached. However, the condition requires consensus only for a period set
5 by the Commission. After that, WEPCO and WPSC can file for rate levelization.
6 Commission staff’s proposal gives the WPSC customers assurance that their rates will
7 not be levelized with WEPCO for a least the period set by the Commission unless these
8 customers agree that the levelization is acceptable.

9 Q. Do you have any comments on the frequently quoted phrase that this merger is not based
10 on immediate cost savings?

11 A. Yes. The Wisconsin Operating Companies are well capitalized and healthy. The
12 applicant has not demonstrated any difficulty of either utility in obtaining capital.
13 Therefore, it is only through synergies that the customers will benefit. Cost savings
14 translate into benefits for ratepayers, after ratepayers have paid for the costs of making
15 those changes. This acquisition, based on WEC’s emphasis that it is not based on
16 immediate cost/synergy savings and/or is not premised on savings, would appear to be
17 based on providing investment opportunities to WEC stockholders (providing them with
18 growth and discontinuing the stock repurchase program), with little concern (“we
19 currently have no plans”) or urgency (“may take years” “over five to 10 years”) for
20 ensuring benefits for customers. In other words, because the Wisconsin Operating
21 Companies are under cost-based regulation there is no holding company urgency.
22 However, WEC stockholder acquisition benefits affect stock prices and executive
23 incentives, so those benefits should be maximized immediately.

1 Q. Do you have any concluding comments?

2 A. Yes. My silence on any other issue should not be construed as agreement with any

3 particular position taken by any witness.

4 Q. Does this conclude your rebuttal testimony?

5 A. Yes, it does.

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